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UNCLAS SECTION 01 OF 03 TEGUCIGALPA 002458

SIPDIS

STATE FOR WHA/CEN, WHA/EPSC, AND EB  
STATE PASS TO USAID AND USTR  
TREASURY FOR DDOUGLASS

E.O. 12958: N/A

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SUBJECT: Honduras: 2003 Monetary and Financial Overview

REF: A: Tegucigalpa 2435

B: Tegucigalpa 2452

1. SUMMARY: Post submits its annual monetary and financial overview for Honduras for the year 2003, based on the official economic statistics released by the GOH in the fall of 2004. Ref A contains information on imports, exports, and the trade deficit, and ref B contains information on economic growth, prices, and wages; this cable contains information on balance of payments, currency, money supply, interest rates, and government spending. Unless cited otherwise, all figures are from the Central Bank of Honduras' annual report.

2. Honduras' current account deficit increased by 18 percent in 2003, as a growing trade deficit was only partially offset by growth in net transfers, mainly family remittances. The capital account and overall balance of payments were also negative. Interest rates continued their decline of recent years, while the monetary position remained stable and the GOH continued its policy of a gradual, controlled devaluation of the lempira. END SUMMARY.

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BALANCE OF PAYMENTS  
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3. Honduras ran a current account deficit in 2003 of USD 258.3 million, 18 percent higher than in 2002, as an increase in net transfers was not sufficient to offset a growing trade deficit. The trade deficit increased by 14 percent in 2003 to USD 1,349.9 million, and net transfers - mostly family remittances from Hondurans living abroad - increased by 13 percent to USD 1,091.6 million. Remittances rose by 21 percent in 2003, to account for 12.8 percent of GDP.

4. Long term direct foreign investment increased by 39 percent over 2002, to reach USD 198.0 million. However, a net outflow of USD 110.2 million in short term investment, coupled with an increase in private sector loans, combined to create a capital account deficit of USD 32.5 million. Honduras' total balance of payments in 2003 was therefore a deficit of USD 231.2 million, and net international reserves fell by USD 88.2 million.

CONDENSED BALANCE OF PAYMENTS (USD MILLIONS)

	2001	2002	2003
Exports	2,510.7	2,570.6	2,711.1
Imports	3,742.2	3,757.9	4,060.9
Trade Balance	-1,231.6	-1,187.4	-1,349.9
Net Transfers	929.2	968.7	1,091.6
Current Account	-302.4	-218.7	-258.3
Capital Account	228.7	232.7	-32.5
Balance of Payments	-0.3	63.5	-231.2
Change in Int. Reserves			
(Decrease +, Increase -)	-147.3	-214.0	88.2

REMITTANCES, IN USD AND AS SHARE OF GDP

Year	Remittances in USD million	As percent of GDP
1999	319	5.9
2000	409	6.9
2001	533	8.5
2002	711	11.1
2003	860	12.8
2004 (est.)	1075	15.5

Note: 2004 figures based upon estimates through September 2004: 3.75 percent annual rate of GDP growth and 25 percent growth in remittances.

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CURRENCY AND MONEY SUPPLY  
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15. The Central Bank continued its policy of a controlled depreciation of the nominal exchange rate of the lempira, using an auction system to regulate the allocation of foreign exchange. The lempira fell from a rate of 16.88 to the dollar at the end of 2002, to 17.95 at the end of 2003, a 6.4 percent devaluation, practically unchanged from the 6.5 percent devaluation of the previous year. The minimum wage increased by an average of 9.7 percent, more than compensating for the rate of inflation.

#### EXCHANGE RATE (LEMPIRAS/USD)

	End of Period	Devaluation in Percent
1998	13.95	5.7
1999	14.62	4.8
2000	15.02	2.8
2001	15.85	5.6
2002	16.88	6.5
2003	17.95	6.4

16. Domestic liquidity, as measured by M1, rose from 13.1 billion lempiras at the end of 2002 to 15.8 billion lempiras at the end of 2003, a 16.5 percent increase in nominal terms (and 9.7 percent in real terms) over the previous year. The money supply shrank in real terms over the first half of the year and grew in the second half of the year, though the rise in the second half failed to spark an increase in bank lending, apparently due to caution exercised by bankers.

#### MONETARY INDICATORS

(December of each year, in millions of Lempiras)

	2001	2002	2003	% var 01/02	% var 02/03
Money (M1)	11,514.8	13,191.6	15,806.8	14.6	19.8
In circulation	5,118.7	5,487.8	6,415.5	7.2	16.9
In deposits	6,396.2	7,703.8	9,391.3	20.4	21.9
Broad Money Supply (M2)	36,314.1	40,444.9	46,422.7	11.4	14.2
Deposits in Foreign Currency	13,801.2	16,288.1	18,654.4	18.0	14.5
Money Supply (M3)	50,115.3	56,733.0	65,077.1	13.2	14.7

#### INTEREST RATES AND CREDIT

17. Nominal interest rates on lempira-denominated loans averaged 20.24 percent in 2003, compared with 22.06 percent in 2002. In early 2004, interest rates fell below 20 percent for the first time in over a decade. (Note: These are the average nominal rates charged by banks to their best customers; small and medium enterprises, on the other hand, complain of a dearth of credit, very short loan periods, and substantially higher average rates. End note.)

#### ANNUAL INTEREST RATES

Year	In Lempiras		In Dollars	
	Lending	Deposit	Lending	Deposit
1999	29.46	15.04	12.86	5.59
2000	24.57	12.23	13.13	5.10
2001	23.18	11.76	12.08	3.58
2002	22.06	9.57	10.93	2.25
2003	20.30	8.14	9.20	1.62

18. Total banking credit to the private sector stood at 49,370 million lempiras at the end of December 2003, following an increase of 12.4 percent in nominal terms. Banks and financial companies are still exercising caution in their lending practices, particularly in the agricultural sector, which saw a net decrease in new loans of 7.5 percent in nominal terms. This caution is the result of a flood of non-performing loans following 1998's Hurricane Mitch, coupled with historically low prices for such key commodities as coffee.

19. New industrial loans rose by 32.5 percent, reflecting the recovery registered by the manufacturing sector, and headed by the maquila sector. Services and real estate loans grew moderately in nominal terms but registered small declines in real terms, despite the growth in both the tourism and construction sectors, which partially benefit from external financial sources. Trade and consumer credits reflected substantial falls in both real and nominal terms. Total credit stock in 2003 grew, while total new loans declined by 6.6 percent in nominal terms.

#### NET INTERNAL CREDIT (MILLIONS OF LEMPIRAS)

	2001	2002	2003	Change 01/02	Change 02/03
Public Sector	-11,395	-12,499	-8,712	9.7%	-30.3%
Private Sector	40,807	43,922	49,370	7.6%	12.4%
Net Internal Credit	29,412	31,422	40,658	6.8%	29.4%

#### PUBLIC SECTOR FINANCES

10. The central government's budget deficit widened to 5.9 percent of GDP in 2003. Government revenue rose by 9.9 percent, to just over 23 billion lempiras (USD 1.3 billion). Much of the increase in revenues is due to increased tax compliance, stemming from a crackdown on tax evaders that led to the temporary closure of more than 1,600 businesses during 2003. Revenue collected from taxes grew by 7 percent in 2002, and by 14 percent in 2003.

11. However, government expenditure increased by 13.1 percent, owing to the ballooning public wage bill (not brought under control until December 2003) and to government financing of several agricultural relief schemes, estimated at a cost of around 1.2 percent of GDP. The financing of the resulting deficit came mostly from internal credit, particularly a 1.2 billion lempira loan from the Central Bank, guaranteed by transfers from Hondutel (the State-owned telephone company). Despite the GOH's poor fiscal performance in 2003, statistics available so far for 2004 show that the government is on track to meet its target of reducing this year's budget deficit to 3.5 percent of GDP, as agreed with the IMF.

#### CENTRAL GOVERNMENT FINANCIAL ACCOUNT

(millions of Lempiras)	2001	2002	2003
Gov't Income	19,726.5	20,977.1	23,055.3
From Taxes	16,083.1	17,229.0	19,632.4
Other Sources	3,643.4	3,748.4	3,422.9
Gov't Expenditure	24,966.4	26,644.6	30,135.6
Budget Deficit	5,239.9	5,667.2	7,080.3
As % of GDP	5.3%	5.2%	5.9%

12. Honduras's foreign debt, which is held by the official sector, Central Bank, and private sector (financial and non-financial), was USD 5,115.6 billion in the year 2003, up 3.1 percent from 2002. The increase was mainly due to the U.S. dollar's depreciation with respect to other currencies that make up the "baskets" of the international lending institutions. In 2003, loans from multilateral and bilateral institutions totaled USD 489.5 million, USD 287.7 million to the private sector and USD 201.8 million to the public sector. Foreign debt service in 2003 was USD 503.3 million, USD 413.5 million of capital and USD 89.8 million in interest. The GOH continues its policy of taking on only foreign concessional loans for projects of high priority, and expects to reach its HIPC completion point in the first quarter of 2005.

#### HONDURAN FOREIGN DEBT (IN USD MILLIONS)

Type of Creditor	2001	2002	2003	%age
Multilateral	3,118.3	3,162.2	3,324.2	65.0
Bilateral	1,414.6	1,487.5	1,538.7	30.5
Commercial	275.1	314.0	252.7	4.5
TOTAL	4,808.0	4,963.7	5,115.6	100.0

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